

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Wesson Analyst: Marion Mann DeJong Bill Number: AB 41

Related Bills: See Legislative History Telephone: 845-6979 Amended Date: 06/28/1999

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Cash Bond Payments/Claim For Refund

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY OF BILL

This bill would allow a taxpayer to make a deposit in the nature of a "cash bond" to stop the running of interest and provide that such payments shall not be considered a "payment of tax" for purposes of filing a claim for refund or bringing an action.

SUMMARY OF AMENDMENT

The June 28, 1999, amendments deleted the provisions relating to the taxpayers' right to raise new grounds, inserted provisions that the payment will not be considered a "payment of tax" until specified affirmative actions by the taxpayer occur, and made the promulgation of regulations by the department optional. The June 28, 1999, amendments accomplish the same result as the previous amendments, they just use a different method of achieving that result.

This analysis replaces all previous analyses.

EFFECTIVE DATE

This bill would become effective January 1, 2000, and would apply to payments made on or after that date.

LEGISLATIVE HISTORY

AB 1469 (1998) was almost identical to the cash bond provision of this bill, as introduced on December 7, 1998. The Governor vetoed AB 1469 for an item unrelated to cash bonds. AB 1392 (1999), a similar bill, would allow a taxpayer to bring an action to determine the validity of a tax by posting a bond to guarantee payment of the amount due.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input checked="" type="checkbox"/> N	<input type="checkbox"/> OUA	<input type="checkbox"/> PENDING

Department/Legislative Director Date

Johnnie Lou Rosas 07/08/1999

SPECIFIC FINDINGS

Current federal and California law provides for the payment of interest on overpayments of tax. Cash bonds and "voluntary payments" are not overpayments of tax; thus, interest is not paid when these amounts are refunded to the taxpayer.

Current federal law allows a taxpayer to file a petition with the Tax Court for a redetermination of a deficiency within 90 days (150 days if addressed to persons outside the United States) after the notice of deficiency is mailed. No assessment of a deficiency may be made until after the expiration of the 90-day period, or if petition is filed, until the decision of the Tax Court is final.

Current federal procedures (Rev. Proc. 84-58) allow a deposit in the nature of a cash bond while a deficiency is pending in administrative proceedings or Tax Court. The bond amount may be refunded without interest at any time, and if the taxpayer prevails in administrative proceedings, the entire bond may be refunded to the taxpayer without interest. This is an important strategic tool for taxpayers because a taxpayer can make a payment in the nature of a cash bond to stop the accrual of interest while preserving the jurisdiction of the Tax Court to review the underlying deficiency. A Tax Court decision can be appealed all the way to the Supreme Court without paying the deficiency. However, collection of amounts affirmed by the Tax Court is not stayed during appellate review when a bond is posted with the court. **Under California law**, unlike the federal system, an unpaid deficiency cannot be appealed to a state court.

Under federal law and procedures, if during the administrative review or appeals process a taxpayer pays a proposed deficiency rather than posting a cash bond, no notice of deficiency is issued and taxpayers are precluded from challenging the assessment in Tax Court. The taxpayer must start over from the beginning with a refund claim that is treated as a new case. The taxpayer must then bring a new action for refund in an U.S. district court or the U.S. Court of Claims rather than the Tax Court.

Under current state law, if the department determines that the tax disclosed by the taxpayer is less than the tax disclosed by the department's examination of the taxpayer's return, it mails a notice of proposed assessment (NPA) to the taxpayer. By law, each NPA must set forth the reasons for the proposed deficiency assessment and the computation of the deficiency. It is departmental policy to sufficiently inform taxpayers as to the basis of an NPA. Often the department sends schedules and other letters detailing the adjustments that produced the NPA.

If the taxpayer disagrees with the proposed assessment, a protest stating the grounds upon which the protest is based must be filed with the department in writing within 60 days. If a protest is not filed within 60 days, the assessment becomes final.

Upon receipt of the protest, the department reviews its information, including any additional information received with the protest. Under departmental policy, the taxpayer and staff are allowed to raise new issues during the protest. After reaching a decision based on the review, the department sends the taxpayer a notice of action (NOA) that withdraws, revises, or affirms the NPA.

A taxpayer that disagrees with the NOA may appeal the department's action on the protest to the BOE within 30 days. If an appeal is not made within 30 days, the assessment becomes final. The appeal must be in writing and include any supporting documents. To determine the appeal, the BOE requires written statements or briefs and, upon request of the taxpayer, an oral hearing. During the appeal process, departmental policy follows BOE's general practice. The taxpayer and staff are allowed to raise new issues. However, if staff raises a new issue, the burden of proof shifts to the department in that area. Under current BOE rules, the department has approximately 90 days to file its opening brief with the BOE and 30 days, or less, to reply to any additional statements the taxpayer may have filed with the BOE.

After the BOE makes a determination, the determination becomes final after 30 days unless the taxpayer or department files a petition for rehearing, which the BOE has discretion in granting. Upon a rehearing, the determination of the BOE is final. At the conclusion of the administrative hearing process, if the taxpayer disagrees with the assessment, the taxpayer may pay the amount due and file a claim for refund.

If the claim for refund is denied or the department has not taken action on the claim for six months, the taxpayer may bring a suit for refund in Superior Court. The department may not appeal or file a Superior Court action following an adverse decision by the BOE.

A taxpayer can file a claim for refund of an overpayment at any time within the applicable statute of limitations. California law requires the taxpayer to state the specific grounds upon which a claim is made.

In reviewing any claim for refund, the department evaluates the taxpayer's grounds and issues an NOA allowing, revising, or disallowing the claim for refund. If the department fails to issue an NOA within six months, the claim is deemed denied.

A taxpayer that disagrees with the department's action may appeal to the BOE¹ or file a suit for refund in Superior Court within 90 days stating the basis of the disagreement. Case law is clear that, for purposes of claims for refund, taxpayers may not raise new issues, beyond those raised as the basis for the refund claim, after the statute of limitation has expired.

If, after filing a protest of an NPA with the department or filing an appeal of the department's action on the protest with the BOE, a taxpayer pays the tax before the department acts upon the protest, or before the BOE acts upon the appeal, the protest or appeal is treated as a claim for refund or an appeal from the denial of a claim for refund. Where a protest or appeal is converted in this manner, the grounds for the claim are those stated in the taxpayer's protest or appeal. For protests or appeals converted to claims for refund, the BOE may allow taxpayers to raise new issues. However, the department is precluded from auditing the converted claim with respect to the new reason for the claim. In this instance, the burden of proof rests with the taxpayer concerning the new issue. However, if the taxpayer satisfies its burden of proof, the department

¹ Taxpayers that appeal the department's action on a protest to the BOE and receive an adverse determination will have a subsequent appeal to the BOE of the denial of a claim for refund on the same grounds summarily denied. To obtain a different result they must file a suit for refund in Superior Court.

may not have adequate time to provide factual or legal analysis of the new issue since the department is limited to the BOE appeal procedure time frames (generally 90 days to respond to an opening brief and 30 days to respond to a supplemental brief).

Current department practice with respect to payments of tax made during an audit is to treat them as payments for the year in question and to show them as payments reducing the balance due when a proposed deficiency assessment is finally issued. If the payments exceed the proposed assessment amount, the excess is refunded with interest.

If a taxpayer wants to post a "cash bond" rather than make a payment of tax, **current department procedures** treat such payments as "voluntary payments" that do not earn interest. However, this is an unusual occurrence because it is beneficial to the taxpayer to have the payment designated as a payment of tax, so that interest can be paid on the overpayment in the event the taxpayer is successful.

This bill would allow a taxpayer to make a deposit in the nature of a "cash bond" to stop the running of interest on a deficiency assessment. Such payments would not be considered a "payment of tax" for purposes of filing a claim for refund or bringing an action until either (1) the taxpayer provides a written statement to the Franchise Tax Board specifying that the deposit shall be a payment of tax, or (2) the deficiency assessed is final, FTB has issued a notice and demand, and the deficiency assessed is due and payable.

This bill would essentially provide taxpayers additional time to raise new grounds when disputing the validity of a deficiency assessment.

Policy Considerations

This bill would raise the following policy considerations.

- Although taxpayers currently are allowed to raise new issues when appealing the department's action on their protest to the BOE, this bill could delay the appeals process to the extent that more taxpayers present their grounds for dispute before the BOE or taxpayers present their grounds one at a time, creating a 30-day delay each time.
- Disputes are handled most efficiently at the lowest level of review; thus, taxpayers should be encouraged to present their issues as soon as possible.
- Under the federal system a deficiency can be challenged in the Tax Court, and actions for refund are heard in a U.S. District Court or the U.S. Claims Court. The cash bond procedure permits a taxpayer to preserve the existence of an unpaid deficiency to permit litigation in Tax Court. Under the California system, only suits for refund and actions to determine residence can be litigated in court. Thus, the primary tax policy reason that taxpayers use the federal cash bond procedure does not exist with respect to California tax disputes.

Implementation Considerations

This provision essentially would codify current practice. Under current practice, taxpayers can make voluntary payments to stop the running of interest, and they can raise new issues before the BOE.

REGULATIONS

This bill would allow the department to promulgate rules and regulations to adopt *applicable* provisions of federal Revenue Procedure 84-58 (1984-2 C.B. 501).

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

This bill would not result in significant revenue change overall. It is projected that the amount of interest not received in any given year from the posting of cash bonds would approximately equal the savings in interest payments by the department in cases where taxpayers ultimately prevail.

BOARD POSITION

Neutral.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill as introduced December 7, 1998.